

MR. ANGELL: Well, thank you very much. The Chair would like to continue with the practice of having rather brief questions and one question to one panelist, and I'm sure we will be able to get around for two rounds of questions.

The first Commissioner question comes from Commissioner Zoellick.

MR. ZOELLICK: Dr. Harl, I was interested in your comments about the structure of the industry, because you talked about consolidation, but you also made a statement about competition. And it wasn't clear to me whether you felt that consolidation was affecting the competition.

As you undoubtedly know, in many industries around the world today, you're seeing consolidation. It leads to reduction of costs, it leads to efficiencies, it leads to a whole bunch of things.

You gave a list of groups that had gained, and you highlighted producers having a small gain.

I would suspect, given the history of this industry and others, that then, there would be fewer producers over time and that, while we may want to help

with the adjustment process, it wasn't clear to me whether, in your mind, that affected competition.

And just one last variable, land. Some of our other speakers said, Oh, well, there's going to always be a certain amount of land, and therefore, you know, that's a variable that doesn't change.

Not in my mind. Land can either be produced or not, and maybe it would be a great thing for the environment if some of it wasn't produced. And so -- and also, there's other parts of the world.

So help me understand your consolidation structure and its effect on competition.

DR. HARL: Let me address your last point first. I agree that, for every crop, we have a core area of production -- in fact, I have some maps that I have published on this -- a core area of production, then a periphery.

The idea behind the '96 Farm Bill was that the squeezing process would squeeze the periphery out.

So what is interesting is that hasn't happened. In fact, we have a little bit more production with the lower prices; people are hanging on.

They don't want to make the change to grazing land, which is the ultimate move, because that's a major economic jolt even though the beef business is looking a little better now.

Nonetheless, there is some elasticity with respect to moving land in and out of intensive production although it does not work as quickly as some would like.

My concern is that producers, for a long, long time, are going to be in nearly perfect competition.

And as we've seen in the seed business, with about \$15 billion of acquisitions in the last 45 months, about \$8 billion by one company alone, and with genetic modification being a very, very important part of this, there is a huge amount of power that is being amassed.

Concentration has also occurred in the slaughter of animals. We have a four-firm concentration ratio for steer and heifer slaughter --

MR. ZOELLICK: But is it noncompetitive? I mean, I understand that there's consolidation and

there's market power. But the ultimate test is whether there is competition.

DR. HARL: Right. And if we -- let's just take a producer in Iowa, where one particular company is nearly dominant, IBP.

If a producer has a contract, a five-year contract, say, and they come to the end of their five-year contract, and they're offered a new contract, and they say, I can't make it on that, that's squeezing me too much. So they start looking around.

If the nearest competitive slaughter facility is 895 miles away, that's hardly a competitive option.

So what we're concerned about is that independent entrepreneurs have competitive opportunities to acquire inputs, competitive opportunities to process, to sell into processing or sell into exports.

This is what I see down the road as being threatened by the combination of concentration and vertical integration.

A number of things can happen. Agriculture may be about where laborers were 100 years ago. It may

lead to countervailing power. It may lead to bargaining for inputs and bargaining for sale of outputs. That's a possibility.

There are some other solutions, I think, aggressive anti-trust oversight is one.

Although that's not popular in all circles, I do believe every merger and consolidation in the most concentrated areas needs to be examined, not solely from the standpoint of the consumer, which is the traditional way the Department of Justice and FTC do it, but from the standpoint of the impact on producers, looking at it from the bottom up, not necessarily from just the top down.

MR. ZOELLICK: If I could just beg the Chair's indulgence, I want to make sure I understand this point.

In terms of the producers' position, there is another option, which happens in many industries, which is that I may not be able to make shoes by myself, even though I'm a good shoemaker. I may end up having to be part of an organization that makes shoes. And that still allows competition.

You emphasize the individual entrepreneur.
Is that a key element of your model that cannot change?

DR. HARL: I'm not saying it can't change.
The point I was making in my written testimony and also
in the oral was, we don't yet have an agreement on what
that should be, and that's why people are talking past
each other. We have not yet accessed the economic and
social costs in shifting to a different model.

MR. ZOELLICK: Okay.

DR. HARL: We need to have some sort of an
agreement on what the model is from the producers'
perspective.

MR. ANGELL: Mr. Weidenbaum.

MR. WEIDENBAUM: I have a question for Dr.
Hayes. In the previous panel, we were told that, if we
really want to encourage the development of poor
countries overseas, we should support including labor
and environmental standards in trade agreements.

I've been puzzling over that one, and I
must be slow this morning, but I need someone to
explain to me how that would work. Do you want to take
a stab at it?

DR. HAYES: I think if you really oppose a trade agreement, but you don't want to oppose the logic of free trade, then you begin opposing additional constraints.

So saying that we should not have to compete with Chinese labor at \$1 an hour and that they should be paid \$19 an hour is another way of opposing free trade.

MR. ANGELL: Thank you. That is a very clear and understandable response to the question. Commissioner Lewis.

MR. LEWIS: Professor Hayes, you mentioned that China will become a vast market for agricultural goods. What do we need to do to make sure that it becomes a market for U.S. produced goods as opposed to Canadian, Australian, French produced goods?

DR. HAYES: One of the things that's been frustrating to me listening here is that really, with NAFTA, Canada and the U.S. are essentially the same basic production unit. Its like Iowa and Nebraska. So trying to differentiate between us is going to cause trouble.

But in terms of Australia and New Zealand, they don't subsidize, and so, presumably, the most competitive producers will win.

Our analysis has shown that, because we have such a big production base in the U.S., we can respond. Whenever the world needs more production, we tend to get a disproportionate share because other countries with a small production base just have trouble expanding as rapidly as we can.

So the bigger the expansion abroad, the bigger our share will be because we have the ability to do that at minimal cost.

MR. ANGELL: Commissioner Wessel.

MR. WESSEL: Let me continue if I could, though, going back, Mr. Hayes, on your \$90-an-hour theory on labor rights.

DR. HAYES: \$19 an hour.

MR. WESSEL: 19. I'm sorry. As we -- still, 19, same question.

As we looked at the NAFTA negotiations, there were some who were arguing that Mexico's labor laws, which were actually quite good, were not being enforced.

And from an economist's point of view, as those who looked at how we might compete with Mexico, we looked at the full body of laws, the full body of how labor markets, environmental and other laws worked as we looked at the overall integration of our economy.

What's your view on simply requiring that other countries --

As we move forward on trade, as we integrate our economies, we require that they apply the rule of law, whether it's on intellectual property, whether it's on their labor rights, whether it's on environment, notwithstanding the other question of those who want to impose much higher standards?

DR. HAYES: This is getting further away from my own area of expertise. But my own sense is that, if you trade with a country in a lower prosperity to develop trade, then wages and economic conditions will rise naturally. And that's what history has shown.

When you begin imposing additional constraints on trade agreements to suit particular groups in the U.S., you essentially slow down their process and ultimately have a negative impact on the

opportunity of poor people in those countries to get higher wages.

MR. WESSEL: But if, for example, in Mexico, there are artificial barriers to wages going up, meaning what's known as the el pacto, that does not --

DR. HAYES: What?

MR. WESSEL: El pacto, which is an artificial barrier to wages rising each year. Does that not limit our ability to create a consumer market in their country, not only to buy our products as well as their own, but clearly to reduce the downward pressure on our own wages?

Shouldn't we allow free markets, free labor markets, to exist as well so that, if a worker wants to bargain for a higher wage, their laws will allow that?

DR. HAYES: I think if Mexico is keeping its wages down illegally, then, that's something we should be concerned about and certainly that the Mexican workers should be concerned about.

I'm just not sure that ruining the opportunity for new trade agreements is the effective tool to do that.

And I think new trade agreements in general will run a bigger impact on the Mexican workers, because eventually they will run out of cheap labor, than if we stop good trade agreements because we know there's some illegal labor laws down there.

And so it's just a matter of which tool you use, and it's a very blunt instrument to stop prosperity creating trade agreements because you know that something is going on in another country.

MR. ANGELL: Commissioner Rumsfeld.

MR. RUMSFELD: Dr. Harl, just a clarification. When you referred to the two-track marketing system, you were talking about the non-genetically modified and the genetically modified?

DR. HARL: Correct.

MR. RUMSFELD: And the reason the expenses, the ones you discussed, concerning pollen drift and mixing things and all of that, add to the cost level.

DR. HARL: It does add a cost at every stage.

MR. RUMSFELD: How important is it? What are the implications for the trade deficit?

DR. HARL: Well, I think the implications are: a) if we don't provide a product that consumers in countries that object to GMO's want, we're going to lose that segment of the demand, and that's a growing segment.

Now, the question is, are we going to write that off, or are we going to try to compete effectively for that market? And if we are, then that's what leads us into a two-track market --

MR. RUMSFELD: I see.

DR. HARL: -- in order to have the product that they want and will meet their specifications in terms of tolerance level.

MR. RUMSFELD: Labeling is not an added cost, I wouldn't think.

DR. HARL: I'm convinced that labeling is a very modest cost item. Now, there are those who argue otherwise. But I think, really, once you get it implemented, it's not very costly.

But one thing we could do is say we're going to produce all GMO's in Iowa and all non-GMO's in Nebraska. And that way, with the Missouri River in

between, we might have a little extra buffering, we might get --

MR. RUMSFELD: You need a system to impose that.

DR. HARL: But that's not the kind of system we have. We don't handle things that way.

MR. ANGELL: Professor Harl, the Chair gets to ask a question each round.

And I want to ask you to help me with the exploration of something I hadn't thought about that much before today.

Does the consumer have the right to information that the consumer might use in a discriminatory fashion?

For example, USDA stamps on beef that makes no distinction between beef that is produced in Iowa and beef that is produced in, say, some other country, going to Canada, and then ends up in the U.S. with the same USDA stamp.

Ordinarily, I would tend to say, Well, what is the purpose of having the label?

But when you think about a world in which all kinds of labels are there, is it justified for the

consumer to have, if they want, a choice between safety graded imported beef versus domestically produced?

DR. HARL: I think the question is, what are the consequences of not doing it? And I think for those who are sensitive, they will tend toward organic products.

We have in place regulations now -- or about to be in place -- and they're pretty tough. They're much tougher than the first round of proposed regs, announced several months ago.

That segment, organic, is growing rapidly anyway. So we would have de facto labeling, if you will, as that small niche grows to meet that demand, both here and abroad. So the question is, do we want to leave it to develop that way?

The markets are going to call the shots here. If a consumer wants one kind of rice, they're going to get it. And we've seen, around the world, some kinds of rice are acceptable, some are not acceptable depending on preferences.

And they may not have that much difference in terms of nutritional qualities. But if the consumer wants something, my view is, they're our boss.

Every morning, as we stare in the mirror the first time, we need to say, "The consumer is the person we work for in our system."

This is not a centrally directed Soviet system. This is the American system, and the consumer, I think, deserves to have available whatever they want in terms of product. The burden has to be on those who argue against that.

MR. ANGELL: Thank you. Commissioner Papadimitriou.

MR. PAPADIMITRIOU: Thank you, Mr. Chairman. Professor Hayes, I really like your charts. They're very clear and very colorful.

But I'm a little bit suspicious of the trends, in light of the previous testimony we heard about perhaps the not-so-bright prospects for the agricultural exports.

How comfortable are you with those projections? And I'm referring actually to the Charts 1, 2, and 3.

DR. HAYES: First, these are not my projections. When I was invited down, I thought I would get the best available projections, and I chose

these with the permission of the group that published them, at Iowa State at Missouri. But they're not my own.

Until two years ago, I ran this group. But I don't do so anymore.

MR. PAPADIMITRIOU: What is then your evaluation of these charts.

DR. HAYES: I guess the bulk of my testimony was to suggest that there are opportunities for greatly exceeding these exports, and particularly if China comes in or we get new trade agreements or new methods of transporting value-added products.

But the bulk of my experience has been that if something can go wrong, it will. And so usually the people who make these projections cannot anticipate the Asian Flu or other things that might go wrong, and they tend to be very conservative for that reason.

The actual models are suggesting bigger exports, so they back them off a little bit.

So my bottom line is this is the best that can be done, looking forward. They have had a good track record in the past.

My own testimony suggests there are ways of improving upon this. But as I said, reality shows that sometimes things will go wrong, too.

MR. PAPADIMITRIOU: Are you suggesting that, in fact, these could become better?

DR. HAYES: Yes. A lot better, if we reduce our exports of raw commodities such as grain and add value to that here and export them. And that's what economic forces seem to have been asking for over the last 15 years.

MR. PAPADIMITRIOU: What we heard earlier was quite different. That's really why I am suspicious about the optimism shown on this chart.

DR. HAYES: Well, the testimony I heard earlier was that we've had a downturn, as with the Asian Flu. And also that agricultural incomes are low, and that's also true.

It's possible to have increasing exports and low agricultural incomes. Especially if the market anticipates increased exports and produces for them, then prices will not rise.

MR. PAPADIMITRIOU: Again, we heard different testimony on the meats category, which actually was quite the opposite.

DR. HAYES: But that data, the historic data, is USDA data. If you turn to page 3 and 4, you'll see the history of U.S. meat exports. And that's all well known, well accepted data from the U.S. Government.

MR. ANGELL: Dr. Barkema, you've got a lot of background of analysis, and I want to make sure we make full use of that.

Looking at the somewhat rosier estimates from the International Monetary Fund and other estimates for the growth of income and output in China, Mexico, even the non-Japanese Southeast Asian countries, is it possible that we might have a faster rebound of agricultural exports than we are anticipating? Dr. Hayes' estimates may also appear somewhat more optimistic.

DR. BARKEMA: I think that opportunity is there. Most of the data that we've been describing thus far focus on the value of agricultural exports from the United States, which, as we said, will likely

remain flat another year. But in fact, export volumes are actually beginning to climb already.

And essentially, there's a second element in all of this. This downturn in foreign demand came at a time when global production was being ramped up, mainly because of big crops.

So we had a collision of weak demand and big crops pushing prices down, which eroded export values as well. So that's part of what we're seeing.

As we do see some rebuilding of global demand, and as you mentioned and Dr. Harl mentioned, the Asian economy has come back much more quickly than many expected, I think there is a foundation being built under demand once again, which will be very positive going forward.

MR. ANGELL: Commissioner Weidenbaum.

MR. WEIDENBAUM: Thank you. I wanted to follow up Chairman Angell's question for Dr. Barkema.

At the previous panel, we heard so much doom and gloom about the current situation in agriculture, but I'm worried about making long-term policy on the basis of short-term events.

Is that a fair conclusion, that the doom and gloom is real, is serious, but it's short-term? This isn't a secular turn in American agriculture?

DR. BARKEMA: I think it's clear that agriculture today does have significant problems. There's no question about that. Prices are down, farm incomes are down, farm subsidies are at record levels.

But it's a unique coincidence of events that the industry is working through right now, a downturn in global demand, a ramping up of global production. This past year, U.S. crop production was at record levels, U.S. meat production also at record levels.

And finally, the industry is now adjusting to a significant change in U.S. farm policy, moving towards a more market-based policy after some 60 years of very significant Government involvement.

All three of these things coincide today, and are due cause for much of the concern in the industry.

I think these are fairly short-term developments.

Now, some of the issues that Dr. Harl articulated very eloquently on the continued structural change in the industry, the structural shift towards larger farms and supply chain relationships with farmers entering contractual relationships with processors and others, those are long-term issues that the industry needs to address going forward.

MR. WEIDENBAUM: Thank you.

MR. ANGELL: And our last question from Commissioner Zoellick. So you get to start and stop.

MR. ZOELLICK: Thank you. There is such a debate about the Freedom to Farm Act, and your last comments start to relate to this.

And I'm just slightly worried, given Dr. Hayes' comment that, just as we're starting to adjust this market through the Freedom to Farm Act, we will change it again, which we've often done in agricultural policy.

So I'd just be curious if any of you have a brief sense of whether this act is on the right track -
- I mean, it can always be probably adjusted -- or whether we need a reversal from that policy?

DR. BARKEMA: Are you addressing that to me?

MR. ZOELLICK: Well, whichever one of you wants to take it.

DR. BARKEMA: My own view is that U.S. farm policy, with the movement towards more market-based policy in Freedom to Farm, is on the right track.

Having said that, there probably is room for some adjustments in the policy.

We know that specific price guarantees called loan rates are probably out of alignment, affecting production decisions including shifts of wheat production into soybean production, even though soybean prices are very low, therefore, I think there is room for making some adjustments at the margins.

But overall, the policy is headed in the right direction.

DR. HARL: I take a less supportive view, but it is a step in the direction of a more economically rational approach to resource allocation if that is our only concern.

But the way it was left - in terms of downside protection -- I think is unacceptable, and I think

it has to be fine-tuned. That's what I think the Congress will be focusing on.

I don't think it's sustainable to be putting \$23 billion a year in subsidies into the sector as in 1999, and that is reality.

We need a better approach where farmers don't have to go, hat in hand, back to Washington and ask for funding.

Moreover, the productivity is rising faster than we can get the products sold.

We had a farmer in Iowa last year who produced three times the present average corn yield, and we're going to march in that direction.

So we've got a huge capacity to produce which is good for consumers, indeed great for consumers who have a wonderful life ahead. But this is going to pose a serious policy issue.

I'm reluctant to say this with Dr. Weidenbaum here, but I have been quoted as saying, and correctly so, that I think the way the 1996 farm bill was left, made it the second most irresponsible Congressional act this century. It needs to be changed.

The basic idea of flexibility in planting needs to be retained, but with fine-tuning.

MR. WEIDENBAUM: I won't ask which the first one was.

DR. HARL: Thank you.

MR. ZOELLICK: Have any of you written on this topic? And I don't mean to ask you to produce it here.

DR. HARL: Yes.

MR. ZOELLICK: But if you've written on it, I'd be interested in seeing what --

DR. HARL: Yes. I do. I'll be happy to supply papers on that argument.

MR. ANGELL: Commissioner Lewis gets one minute into our noon hour.

MR. LEWIS: I hope your paper will also say what the first one was.

DR. HARL: I think your Chair can probably relate that to you in camera.

MR. LEWIS: Professor Harl, I have one question for you. Maybe it's a function of the state I come from, which is Oregon, which has land use planning in our state.

Have you done any analysis or has analysis been done about the loss of farmland in America on a regular basis and what this means for the future of agriculture?

DR. HARL: We have tried. And on this score, as far as you can project, it's going to be a long, long time before it jeopardizes food production.

It's dramatic when you see areas concreted and blacktopped over. But I calculated once it would take 347 years before we run out of tillable acreage.

I think we need to watch it. I think development should be rational. And I think, at the micro level, when cities and other communities make decisions about land use, they need to keep that in mind.

But this is again an economic issue within a constrained set of zoning and developing statutes.

MR. LEWIS: Thank you very much.

MR. ANGELL: The Commission is very, very appreciative of the panelists for their clear testimony.

Professor Hayes, I thought I knew about American agriculture, but I would have failed the test

to have named the current proportions of international trade and agriculture as you've shown on your charts.

Sometimes we are not quite as good at telling the success story, so America's percentage of both crop trade and world meat trade is something that's, I think, very important. And it does show how important agriculture has been in the United States. So, thank you.

(Whereupon, at 12:33 p.m., the meeting was adjourned, to reconvene this same day, Wednesday, April 26, 2000, at 1:30 p.m.)

A-F-T-E-R-N-O-O-N S-E-S-S-I-O-N

(1:34 p.m.)

MR. WEIDENBAUM: Ladies and gentlemen, we are about to start the afternoon session.

MR. ANGELL: As the Chair of the day, I should yield to Chairman Weidenbaum to make the next introduction.

But, Mr. Chairman, I'm not yielding because of my personal knowledge of the President of the Federal Reserve Bank of Kansas City.

In 1972, after some frustration as a professor of economics who wanted to be involved in managing bond portfolios and not being able to find any bank that was willing to trust their bond portfolio to a professor's management, I convinced my brother that we should borrow money in our farm machinery to make down payment on a small bank in Hume, Missouri.

And the year that we put in the application for what I presume was the smallest one-bank holding company in the United States, a new economist in the bank supervision department was Thomas Hoenig.

And so I've known Tom during that period of time and during the period of time including the period

of time that I served as a Director of the Federal Reserve Bank of Kansas City.

And I've had the privilege of watching Tom become a member of Federal Open Market Committee and watching him in that role. Many of you outside the Federal Reserve System do not very often get one former FOMC member introducing another FOMC member and telling stories about him.

And you would be interested to know that it would be about the same as you hear from farmers, and that is, members of the Federal Open Market Committee are very independent, and they follow their view in regard to what they believe to be in the nation's interests.

Tom, I don't see Craig Hakkio -- oh. He's here.

And so, your director of research -- who also we thank, Craig, for your role in helping us with this event. By the way, Craig attends the FOMC meetings with President Hoenig.

And just in case any of you didn't realize it, sometimes they say Thomas Hoenig, Voting Member, or sometimes say Thomas Hoenig, Nonvoting Member. All of

you must understand that every member of the FOMC participates in the discussion.

And it's a delight for me to be back in Kansas City, with no Federal Reserve status, introducing Tom Hoenig. And we welcome and look forward to your remarks.